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Supreme Court, U.S.
FILED
APR 18 1989
JOSEPH F. SPANIOL, JR.
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Docket No. 88-1603

In The

Supreme Court of the United States

October Term 1988

NORTHERN PROPANE GAS COMPANY,

Petitioner

v.

H. FLOYD McGAHEE,

Respondent

RESPONSE TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

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5 1 pp

QUESTIONS PRESENTED

1.

Respondent shows that the first question stated by Petitioner is not fairly presented by the record and decision in this case. Contrary to the assumption implicit in the first question, the Eleventh Circuit did not rule that a firm with a large market share must sell above average total cost plus a reasonable profit in order to avoid subjecting it to the risk that a trier of fact will infer predatory intent. Further, the first question is premised on the assumption that Petitioner's sales were above average variable cost, while the record contains evidence of sales below average variable cost.

2.

Respondent shows the second question stated by Petitioner does not arise from the record in this case. Specifically, the second question is premised on the assumption that there are no barriers to entry in the relevant market, and the assumption that Petitioner had no ability to raise prices in the relevant market. These assumptions are contradicted by the evidence identified in the Eleventh Circuit Decision, and by other facts in the record.

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RESPONSE TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

The Respondent, H. Floyd McGahee, within thirty (30) days after receipt of the Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit (hereinafter "Petition"), submits the following opposition to the Petition.

I. STATEMENT OF THE CASE.

A. Proceedings Below.

Respondent McGahee's Complaint was filed on November 30, 1983. (R1-1-1). The Complaint alleged that Petitioner Northern Propane violated Section 2 of the Sherman Act, 15 U.S.C. Section 2, by monopolizing and attempting to monopolize the retail distribution market for propane gas in a two-

county geographic market located in southwestern Georgia. (R1-1-5). The Complaint further alleged that Petitioner Northern Propane violated Section 2(a) of the Clayton Act, as amended by the Robinson-Patman Act, 49 Stat. 1526, 15 U.S.C. § 13(a), by engaging in unlawful price discrimination. (R1-1-3). On September 4, 1985, Respondent amended his Complaint to clarify the jurisdictional basis of his Robinson-Patman Act claim. (R4-61-1).

On January 7, 1985, Petitioner Northern Propane filed its Motion for Summary Judgment. (R2-1-1). Respondent McGahee responded to the Motion for Summary Judgment by filing an extensive Memorandum of Law as well as detailed Affidavits, approximately 2,178 pages of depositions, and approximately 1,763 pages of deposition exhibits. (R3-31). Respondent subsequently filed the Affidavit of his expert witness, Dr. Bruce Seaman. (R4-58-1 and R4-64-1).

On April 13, 1987, the District Court entered an Order granting Petitioner's Motion for Summary Judgment. *McGahee v. Northern Propane Gas Co.*, 658 F.Supp 189 (N.D. Ga. 1987), Rev'd 858 F.2d 1487 (1988). (R4-71-1). Respondent McGahee appealed. On October 27, 1988, the Eleventh Circuit Court of Appeals reversed the judgment of the District Court. (Pet. 31a). Petitioner's Motion for Rehearing and Rehearing En Banc was denied on December 20, 1988 (Pet. 48a), and Petitioner filed its Petition for Writ of Certiorari on or about March 17, 1989.

B. Facts.

1. Facts Recited In Opinion of Court Below.

Most of the relevant facts are summarized in the opinion of the Court of Appeals. *McGahee v. Northern Propane Gas Co.*, 858 F.2d 1487, 1491-92 (11th Cir. 1988). These facts were reprinted in the Petition at p. 3-6 and will not be quoted again here. However, Petitioner failed to include the Court's footnotes and substi-

tuted its own footnotes without designating them as such. *Compare* Petition, p. 3-6 and notes 1-4 *with* 858 F.2d at 1491-92 and notes 1-7. The Eleventh Circuit's footnotes are integral to an understanding of the factual basis of Respondent's claims.

In summary, the Eleventh Circuit found the record established the following facts pertinent to the instant petition: Petitioner Northern Propane operates one hundred eighty (180) propane outlets in twenty-five (25) states; and at the time it initiated the conduct about which Respondent complains, Petitioner controlled 60 percent of the total product market in the stipulated market area. Except for Respondent, Petitioner's competitors in the market area were based outside the geographic market area and their ability to compete with Petitioner was impaired because of the cost of transporting propane.

Respondent McGahee had been employed by Petitioner. He was demoted by Petitioner, and he subsequently resigned. Eventually, he organized a retail propane outlet, competing head-to-head with Petitioner in the market area. Immediately prior to Respondent opening for business, Petitioner reduced its prices for propane. A price war ensued at the time Respondent opened its doors, and continued until the complaint was filed. During the price war, Petitioner sold propane at prices below its average total cost and, in some instances, below its average variable cost. The prices charged by Petitioner in the market area were below those charged by Petitioner in other areas.

In addition to evidence regarding Petitioner's pricing, the Eleventh Circuit notes other activities by Petitioner. Petitioner obtained copies of Respondent's S.B.A. loan application and other documents related to Respondent's financial condition. Petitioner made a determination to "take the offensive" and "fight" Respondent for the market, and Petitioner established as one of its goals "to contribute to Floyd's financial problems." Petitioner adopted a policy whereby it provided free propane

tanks to its customers in the market area, while charging customers for tank rentals in other areas. This strategy focused on Respondent McGahee's limited capital, and further reduced the price of Petitioner's product. 858 F.2d 1487, 1491-92. (Pet. 1a-3a).

2. Additional Facts Necessary to an Understanding of the Issues.

In addition to the facts stated in the Court's Opinion, there was other evidence of Petitioner's anti-competitive conduct. The record shows that numerous customers who had decided to switch from Petitioner to Respondent had called Petitioner repeatedly to demand that Petitioner pick up its tanks. Plaintiff's Exhibit 78 at C00971. (R3-31). However, Petitioner delayed picking up its tanks so long that the customers would run out of propane. McDaniel Deposition, Volume IV, p. 486, 490. (R3-31). In some instances, Petitioner filled the customer's tank after being told that the customer wanted to switch companies. *Id.* at 490. In other cases, Respondent's delivery men, faced with the choice of putting Respondent's gas in Petitioner's tanks, leaving the customers without gas or replacing Petitioner's tanks, chose to replace the tanks, leaving Petitioner's tanks on the property for Petitioner to pick up at its convenience. Petitioner then reported Respondent to the State Fire Marshal for disconnecting its tanks. Petitioner further pursued its stated goal of contributing to Respondent's financial problems by filing a frivolous lawsuit against Respondent in the United States District Court for the Middle District of Georgia, and by filing an equally frivolous counterclaim in this case. Petitioner dismissed its counterclaim in this action after Respondent moved for Summary Judgment. (R1-25-1), et seq., (R2-32-1); (R2-33-1). Subsequently, United States District Judge J. Robert Elliott granted Respondent McGahee's Motion for Summary Judgment in the Middle District lawsuit, finding that Petitioner was not even the owner

of the account on which it was suing Respondent. Notwithstanding that this fact was known to Petitioner's counsel more than a year before the hearing on the Motion for Summary Judgment, Petitioner litigated the issue until the date of Judge Elliott's ruling. *See* Deposition of Ronald Ingram, Volume II at p. 139-141, 204-205; Letter from Thomas B. Metzsloff to James L. Paul, dated 12/28/84. (R1-25).

3. Misstatements of Fact by Petitioner.

The Petition contains a number of misstatements of facts which are material to the Court's consideration.

(a) Sales Below Average Variable Cost.

Petitioner has premised its entire Petition on the assertion that all of its sales of propane gas were at prices above its average variable cost. Petition, p. 7-8. However, as the Eleventh Circuit repeatedly pointed out, there was sufficient evidence in the record to create a triable issue of fact as to whether or not Petitioner sold propane gas at prices below average variable cost. 858 F.2d 1487, 1492 at n.5, 1495 at n.12 and 1504. (Pet. 4a n.5, 9a n.12 and 27a). *See, e.g.*, Plaintiff's Exhibit 79 at C00812 (R3-31); Exhibit 87 at IN01010, IN01013 and IN01037 (R3-31). Petitioner's own records show sales below average variable cost, even using the average variable costs calculated by Petitioner's own expert, which omitted costs most businesses would consider variable, such as hourly wages, customer tanks, delivery trucks, etc., *see* 858 F.2d 1495, n.12 (Pet. 9a n.12). Thus, from May 1982 through December 1982, Petitioner sold propane to its highest volume industrial accounts at a price of 60.9 cents per gallon. Gower Affidavit, Exhibit D, p. 2 (R2-27); Plaintiff's Exhibit 15 at p. C00907 (R3-31); Plaintiff's Exhibit 16 at p. C00851 (R3-31); Plaintiff's Exhibit 11, p. C00856 (R3-31); Plaintiff's Exhibit 21, p. C00852 (R3-31); Wade Deposition, Vol. III, p. 367. (R3-31). In October, November, and December 1982, Petitioner's own

expert testified that Petitioner's average variable costs exceeded 61.67 cents per gallon. Gower Affidavit, Exhibit C, p. 3, lines 26-28. (R2-27). Thus, during the latter part of 1982, Petitioner's average variable cost exceeded the price at which it was selling propane to its highest volume users.

(b) Barriers to Entry.

In its Petition, Petitioner has repeatedly misstated the facts in the record related to the issue of whether there are barriers to entry in the market. Specifically, Petitioner has repeatedly stated that there are no barriers to entry into the retail propane distribution market in Mitchell and Baker Counties, Georgia; and Petitioner relies on this fact statement in its statement of the questions presented. However, as the Eleventh Circuit noted, whether or not there are barriers to entry sufficient to allow Petitioner to garner supracompetitive profits after destroying Respondent is a question of fact for the jury. *See* 858 F.2d 1487, 1495 at n.11 and 1505 at n.44 (Pet. 9a n.11 and 28a n.44) (suggesting that existence of barriers to entry is a question of fact in this case). The record is replete with evidence from which a jury could find that there are barriers to entry in the retail propane distribution market in southwest Georgia. *See* Part III.B., *infra*. Therefore, Petitioner's repeated statements that there were no barriers to entry into the retail propane distribution market misrepresent the record and the opinion of the Court below.

(c) Injury to Competition.

Petitioner has also insinuated in its Petition that no competitors had been driven from the market by Petitioner's conduct. (Pet. at p. 6). However, Dan Holloway, another competitor of Petitioner, testified that he had been forced from the market by Petitioner's predatory pricing. *See* Holloway Affidavit, ¶ 4 (R3-31). Holloway testified that even after Petitioner's

prices rose to normal competitive levels he was unable to regain the business he had lost. *Id.* He was deterred from reentering the market by the capital costs and the concern that, if he spent the money to place tanks at customers' houses, Petitioner would again cut its prices below cost. (R3-31).

(d) Ability to Charge Supracompetitive Prices.

Finally, Petitioner has stated that it had no ability to charge supracompetitive prices, and its statement of the questions presented assumes such an inability. (Pet. (i), 4 n.1, and 27). However, as the Eleventh Circuit noted, there was evidence in the record from which a jury could find that Petitioner had the ability to charge supracompetitive prices in its other geographical districts. 858 F.2d at 1505 n.42. (Pet. 28a n.42). There was also evidence that the market was stagnant, that Petitioner had sufficient market share and excess capacity to "discipline" any competitors, and that propane gas cannot be sold profitably more than 25-30 miles from a company's storage tanks. Wade Deposition, Vol. I, p. 123 (R3-31); McGahee Affidavit ¶ 6 (R3-31); Ingram Affidavit, at ¶ 6 (R2-27-4); Seaman Affidavit. (R4-58-20). Respondent and Petitioner were the only companies located at the center of the district. The remaining competition, which was fragmented, was located at the edges of the district and therefore had higher transportation costs to service the primary area serviced by Petitioner and Respondent. These facts, plus the testimony of Respondent's expert, Dr. Bruce Seaman, were sufficient to create a triable issue of fact as to whether Petitioner, by eliminating its principal competitor from the market, would have been able to charge supracompetitive prices in the Camilla district.

C. Ruling of the District Court.

On April 13, 1987, the District Court granted Petitioner Northern Propane's Motion for Summary Judgment. *McGahee*

v. Northern Propane Gas Co., 658 F.Supp. 189 (N.D. Ga. 1987) (Pet. 45a). The District Court held that Respondent McGahee had failed to come forward with admissible evidence to support any essential element of its Sherman Act claims. 658 F.Supp. at 1986-197. (Pet. 35a and 42a). In evaluating whether or not Respondent had produced sufficient evidence to create a triable issue of fact as to Petitioner's intent to monopolize, the District Court specifically refused to consider any subjective evidence of intent. (Pet. 37a). The Court stated that it "cannot and need not divine the intent behind Defendant's pricing policy". Disregarding all subjective evidence of intent, the Court held that, as a matter of law, prices above average variable cost are *per se* legal and non-predatory. (Pet. 34a, 37a). Disregarding evidence in the record that Petitioner had in fact priced below its average variable cost, *see* Part I.C.(1) above, the District Court held as a matter of law that Respondent had failed to produce evidence from which a jury could find an attempt to monopolize, in violation of Section 2. 658 F.Supp. at 196. (Pet. 42a).

The District Court also held as a matter of law that there were no barriers to entry into the relevant market, despite record evidence to the contrary. 658 F.Supp at 195. (Pet. 40a-41a). *See* Seaman Affidavit, ¶ 24 (R4-58-20); Part III.B, pp. 14-16, *infra*.

The District Court further held as a matter of law that there was no dangerous probability that Petitioner would succeed in acquiring monopoly power, notwithstanding evidence that Petitioner held 60 percent to 65 percent of the relevant market at the time it commenced its predatory pricing scheme, and notwithstanding evidence that other competitors were driven from the market by Petitioner's conduct, and notwithstanding the testimony of Respondent's expert. (Pet. 42a-43a). *See* Plaintiff's Exhibit 87, p. IN00988, 998, 1028 (R3-31); Holloway Affidavit, at ¶ 4 (R3-31); Seaman Affidavit, ¶ 24. (R4-58).

D. Ruling of the Eleventh Circuit.

In its well-reasoned opinion, the Eleventh Circuit rejected the District Court's *per se* test which excluded subjective evidence of intent. Exhaustively reviewing the decisions of this Court and the other Courts of Appeal, as well as the legislative history of the Sherman Act, the Court found no basis for concluding that subjective evidence of intent is irrelevant in an anti-trust case, or that such evidence could be replaced by economic theory. *See* 858 F.2d at 1493-1502 and note 29. (Pet. 11a-23a and note 29). The Eleventh Circuit concluded that the legislative history of the statute required consideration of subjective, as well as objective, evidence of a defendant's intent to monopolize. (Pet. 18a).

The Eleventh Circuit analyzed the decisions of this Court and decisions from other circuits in determining the proper treatment of evidence of pricing below either average total cost or average variable cost. Contrary to Petitioner's characterization of the ruling, the Eleventh Circuit did *not* hold that predatory intent could be inferred simply from sales which were below average total cost but above average variable cost. The Eleventh Circuit specifically held that sales below average total cost but above average variable cost were merely circumstantial evidence of predatory intent; and the court held that an "inference of predatory intent, however, may not rest solely on prices of this nature." 858 F.Supp. at 1503. (Pet. 25a). The Eleventh Circuit held that in order to withstand a motion for summary judgment, a plaintiff must come forward with additional objective and/or subjective evidence of predatory intent. *Id.* The court held that sales *below* average variable cost would constitute circumstantial evidence strong enough to create a rebuttable presumption of predatory intent. *Id.* at 1504. (Pet. 26a). Again, the court held that both objective and subjective evidence are admissible to rebut or reinforce the presumption. *Id.*

Finding record evidence of sales below average total cost as well as sales below average variable cost, and finding subjective evidence of Petitioner's intent to monopolize, the Eleventh Circuit found genuine issues of fact "as to whether Northern Propane had the intent necessary for an attempt to monopolize claim." *Id.* at p. 1504-5. (Pet. 27a).

The Court of Appeals also found genuine issues of fact as to whether or not Petitioner's predatory pricing scheme had a dangerous probability of success. 858 F.2d at 1506. (Pet. 30a). The court held that Petitioner's 60 percent to 65 percent market share "is a sufficiently large platform from which such a scheme could be launched to create a genuine issue of material fact as to whether there was a dangerous probability that Northern Propane would succeed in achieving a monopoly." 858 F.2d at 1506. (Pet. 30a). The court noted that Petitioner had the apparent ability to charge supracompetitive prices in other districts, and that there was evidence that some competitors had already withdrawn from the market at issue in this case. 858 F.2d at 1505 n.42 and 1506 n.45 (Pet. 28a n.42 and 30a n.45); *See* Holloway Affidavit, ¶ 4 (R3-31). The court also noted the Affidavit testimony of Respondent's expert that there was a dangerous probability of success. *Id.* at 1506 n.45. (Pet. 30a).

The Eleventh Circuit also found questions of fact as to whether there were barriers to entry which would enable Petitioner to reap the benefits of a predatory pricing campaign through supracompetitive pricing after the elimination of Respondent. 858 F.2d at 1495, n.11 and 1505, n.44. (Pet. 9a n.11 and 28a n.44).

II. SUMMARY OF ARGUMENT.

First: The first question which Petitioner claims is presented in this case does not fairly arise from the opinion of the Eleventh Circuit; and the question is premised on facts which are actually in dispute. Contrary to the assumption implicit in

the first question presented by the Petitioner, the Eleventh Circuit did not rule that a firm with a large market share must sell above average total cost plus a reasonable profit in order to avoid an inference of predatory intent. Further, the first question is premised on a factual premise that is contradicted by record evidence that Petitioner sold below average variable cost. (*See* III.A. *infra*).

Second: The second question which Petitioner claims is presented is premised on the assumption there were no barriers to entry in the relevant market and the assumption that Petitioner had no ability to raise prices in the market. These assumptions are contradicted by the evidence identified in the Eleventh Circuit decision, and by other facts in the record. In addition, Petitioner's second question is premised on a mistaken characterization of this Court's ruling in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 590 (1986). Thus, the second question Petitioner attempts to present does not fairly arise from the record in this case. (*See* III.B., *infra*).

Third: There are no real conflicts among the circuits as to the Eleventh Circuit's holding that subjective evidence of intent is properly admissible in a predatory pricing case to show predatory intent. No circuit has held, as did the District Court in this case, that subjective evidence of intent is irrelevant. The Eleventh Circuit's holding that sales between average variable cost and average total cost can be circumstantial evidence of predatory pricing which can be considered by the fact finder, is not in conflict with other circuits. Regardless of the terminology used, no circuit has held, as did the District Court in this case, that prices above average variable cost are conclusively and irrebuttably non-predatory. Finally, no circuit has affirmed a summary judgment in favor of a defendant where the record, as in the present case, shows sales below average variable cost and contains other objective and subjective evidence of predatory intent. (*See* III.C., *infra*).

Fourth: The Eleventh Circuit's holding does not conflict with any ruling of this Court. This Court has never held that subjective evidence of intent is not admissible in a predatory pricing case to show predatory intent. The Eleventh Circuit's decision that evidence of sales below average total cost can be circumstantial evidence of predatory intent is consistent with this Court's ruling in *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967), and is not in conflict with any decision of this Court. (*See* III.D., *infra*).

Fifth: The Eleventh Circuit's holding that the record in this case established a factual dispute as to whether or not there was a dangerous probability that Petitioner would succeed in its attempt to monopolize is not inconsistent with the rulings of other Circuits. Nor does this holding conflict with any prior rulings of this Court. (*See* III.E., *infra*).

Sixth: The Petition does not fairly present an important federal question. The Eleventh Circuit's decision reversed a summary judgment and found factual disputes to be tried. The questions posed by Petitioner assume adjudication, in Petitioner's favor, of those contested facts. The Writ should not be granted to decide legal issues which hinge on factual determinations presently in dispute. (*See* III.F., *infra*).

III. REASONS WHY THE WRIT SHOULD BE DENIED.

A. THE WRIT SHOULD BE DENIED REGARDING QUESTION NO. 1 BECAUSE QUESTION NO. 1 IS NOT PRESENTED BY THE OPINION OF THE COURT BELOW.

Petitioner contends that the first question presented is:

> Do the federal antitrust laws require a firm with a large market share to refrain from selling below its average total cost plus a reasonable profit, and subject it to the risk that a trier of fact will infer "predatory intent" if the firm

reduces prices to protect its market share and sells below average total cost, but above average variable cost?

Respondent submits the Writ of Certiorari should be denied as to this question because the question mischaracterizes the Eleventh Circuit's holding and the question is premised on factual assumptions contradicted by the record.

Nothing in the Eleventh Circuit's Decision requires a company to sell at prices "above average total cost plus a reasonable profit". The Eleventh Circuit specifically held that sales below average total cost would not, by themselves, support any inference of predatory intent. 858 F.2d at 1053 (Pet. 25a). Under the Eleventh Circuit's test, sales below average total cost, but above average variable cost, are meaningless unless there is additional evidence of predatory intent. *Id.*

The Eleventh Circuit also held that there was evidence in the record that Petitioner had sold propane gas to its largest commercial customers at prices below average variable cost. 858 F.2d at 1492 n.5, 1495 n.12, and 1504 and n.41 (Pet. 4a n.5, 9a n.12, and 27a and n.41). The Court found that this evidence, plus the other evidence in the record, created a triable issue of fact as to whether Petitioner had the intent necessary for an attempted monopolization claim. *Id.* at 1504. (Pet. 27a).

Since Question No. 1 as stated in the Petition is not fairly presented by the opinion of the Court below, and since it assumes facts which are in dispute, this Court should deny the Writ as to this question. *Southern Power Co. v. North Carolina Public Service Co.*, 263 U.S. 508 (1924); *Accord, National Labor Relations Board v. Hendricks County Rural Electric Corp.*, 454 U.S. 170, 176 n.8 (1981).

B. THE WRIT SHOULD BE DENIED REGARDING QUESTION NO. 2 BECAUSE QUESTION NO. 2 IS NOT PRESENTED BY THE OPINION BELOW.

The second question as to which Petitioner seeks the Writ of Certiorari is:

> In view of the ruling in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 590 (1986), that the "prospects of attaining monopoly power [by predatory pricing] seems slight", is evidence of a large market share alone sufficient in a predatory pricing case to raise a triable issue of fact as to the existence of a "dangerous probability" of monopolization, where there are no barriers to entry, there has been a sharp decline in the Defendant's market share at the hands of a new entrant during the period of alleged predation, and Defendant does not have the power to raise prices in the market?

Respondent submits the Writ of Certiorari should be denied as to this question because the question is not presented by the Eleventh Circuit's Opinion or the record in this case.

First, the question assumes that it is undisputed that there are no barriers to entry in this case. However, as the Eleventh Circuit pointed out, there are facts in the record from which a jury could infer that there were sufficiently high barriers to entry to allow Petitioner to reap the benefits of its predatory pricing policy. 858 F.2d at 1495 n.11 and 1505 n.44 (Pet. 9a n.11 and 28a n.44). The Affidavit of H. Floyd McGahee showed the substantial capital requirements required before a single gallon of gas could be sold. McGahee Affidavit, ¶ 4. (R3-31). (Appendix, *infra*, at 18a-21a). Earl Wade, Petitioner's District Manager, testified that before a company could sell a single gallon of propane, it needed an office, office employees, bulk storage tanks,

trucks, truck drivers, and administrative personnel. Wade Affidavit, ¶ 29. (R2-27). *See also* Ingram Affidavit, at ¶ 3. (R2-27). The substantial capital requirements for opening a propane business are further documented by the testimony of Dan Holloway, the president and owner of Modern Gas Company. Holloway Affidavit, at ¶ 5. (R3-31). *See also* Taylor Affidavit, at ¶ 3. (R3-31).

The substantial capital requirements must be considered in conjunction with other factors. First, the Mitchell-Baker County retail propane market was stagnant at all times relevant to this case. The total size of the market is approximately 3,700,000 to 4,000,000 gallons of propane per year. Wade Deposition, Volume I, p. 123 (R3-31); McGahee Affidavit, at ¶ 6. (R3-31). (Appendix, *infra*, 19a). A person entering the retail propane business in this market is faced with the question of whether he can receive a reasonable return on the capital outlay of approximately $975,000 to $1,125,000 which it will cost to enter the market. Petitioner's own witnesses have testified that Petitioner expected an 18 percent return on capital per year. Ingram Affidavit, at ¶ 13. (R2-27). Respondent McGahee has testified that he considers a reasonable return on capital in the retail propane business to be at least 12 percent per annum. McGahee Affidavit, at ¶ 7. (R3-31). A new investor would need to earn net profits of at least $125,000 to $135,000 to receive a 12 percent return on an investment of $975,000 to $1,125,000. Thus, a propane dealer selling one million gallons per year, or 25 percent of this market, would need a return of about 12 cents per gallon in order to recover a 12 percent return on capital. As Respondent McGahee's Affidavit shows, it would be extremely difficult for a new entry in the Mitchell-Baker County market to achieve 25 percent penetration even in the absence of predatory pricing by Petitioner. McGahee Affidavit, at ¶ 7. (R3-31) (Appendix, *infra*, 19a-20a). It would also be extremely difficult

to recover 12 cents per gallon above all direct and indirect costs in order to receive a 12 percent return on investment. *Id.* As testified by Respondent's expert, Dr. Bruce Seaman, there are substantial barriers to entry in the Mitchell-Baker County propane market because of the large capital outlays required, the inelastic nature of the Mitchell-Baker County propane market, and the ability of the existing retail propane outlets to serve this market. Seaman Affidavit, at ¶¶ 21, 23. (R4-58-20). (Appendix, *infra*, 12a, 14a-15a).

In addition, Dr. Seaman testified in his Affidavit that the deterrent effect of a successful predatory pricing campaign, even at prices above average variable cost, together with the above factor, could substantially deter new competition from entering the market. Seaman Affidavit, at ¶ 16, ¶ 21, and ¶ 23. (R4-58). (Appendix, *infra*, 12a, 14a-15a). *See also Posner, The Chicago School of Antitrust Analysis*, 127 U. Penn. L. Rev. 925, 939-940 (1979); Joskow & Klevorick, *A Framework for Analyzing Predatory Pricing Policy*, 89 Yale L.J. 213, 252-253 (1979); Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 Yale L.J. 284 (1977). This testimony was corroborated by the testimony of Dan Holloway, a competitor who decided not to incur the expense of returning to the market once prices rose because of concern that he would again lose customers as a result of Petitioner's prices. Holloway Affidavit, at ¶ 4. (R3-31). Based on the above, a jury could reasonably infer that substantial barriers to entry exist which would deter new competition from entering the market long enough for Petitioner to recoup the losses incurred in its predatory pricing campaign. Thus, the basic factual premise of Petitioner's second question, that there were no barriers to entry in this case, was rejected by the Eleventh Circuit and is contradicted by the record.

Second, Petitioner's second question is also premised on the factual misstatement that Petitioner does not have the

power to raise prices in the market. While it is true that Petitioner did not, prior to the institution of its predatory pricing strategy, charge supracompetitive prices in the Mitchell-Baker County market, it is equally true that Petitioner has been able to charge supracompetitive prices in other districts. 858 F.2d at 1505 n.42. (Pet. 28a n.42). There was also other evidence from which the jury could infer that Petitioner had the power to control prices. Petitioner's own documents show that it had a 60 percent to 65 percent market share and that the remainder of the market was fragmented between several smaller competitors, most of whom were located on the geographical fringes of the district and were therefore unable to compete effectively in the heart of the district because of transportation costs. Plaintiff's Exhibit 87 at p. IN00988, 998, 1028. (R3-31). It was also undisputed that Petitioner had excess capacity. *See* Petition, p. 7. The Affidavits of Dan Holloway and Floyd McGahee made it clear that Petitioner's competitors were forced either to follow Petitioner's price cuts and suffer ruinous losses or to abandon the market altogether. These facts, plus the testimony of Dr. Seaman regarding the deterrent effect of a successful predatory pricing campaign, are sufficient for a jury to conclude that Petitioner would have the power to maintain supracompetitive prices after eliminating its principal competitor. The Petitioner's second question, which assumes a contrary fact, thus does not fairly arise from the record in this case.

Third, Petitioner's second question is also premised on the irrelevant statement that Petitioner initially lost market share to Respondent. Respondent's initial ability to obtain customers is completely irrelevant to the issue of whether there was a dangerous probability that Petitioner's action, if continued, would have allowed Petitioner to acquire monopoly power. *See Multiflex, Inc. v. Samuel Moore & Co.*, 709 F.2d 980, 992-93 (5th Cir. 1983), *cert. denied* 465 U.S. 1100 (1984); *Pacific Coast Agricultural*

Export Association v. Sunkist Growers, Inc., 526 F.2d 1196 (9th Cir. 1975), *cert. denied* 425 U.S. 959 (1976) (market share ranging from 45 percent to 70 percent sufficient to show monopoly power). Respondent's success in winning customers was attributable by Petitioner's own admissions to Respondent's experience and familiarity with his customers and their needs. See Plaintiff's Exhibit 81 at C00734 (R3-31); Wade Dep., Vol. I at p. 82. (R3-31). However, Respondent was unable to retain the customers because, unlike Petitioner, he was unable to subsidize the losses caused by below-cost pricing with supracompetitive profits earned in other geographic markets. McGahee Affidavit, ¶¶ 30-32. (R3-31). *See* 858 F.2d at 1505 n.42. (Pet. 28a, n.42).

This Court has previously held that a new entrant's success in acquiring market share from the dominant firm is irrelevant to whether or not an antitrust violation occurred. *See Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685, 702 n.14 (1967) ("the Clayton Act's proscription as to discrimination in price is not nullified merely because of a showing that the existing competition in a particular market had a major share of the sales of the product involved"). *Accord, Multiflex, Inc. v. Samuel Moore & Co., supra.*

Finally, Petitioner's second question is premised on an incorrect statement of this Court's holding in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), and an incorrect statement of facts. Contrary to Petitioner's statement, this Court did not, in *Matsushita*, make a general ruling applicable to all cases regarding the viability of predatory pricing schemes. In fact, the portion of the *Matsushita* Opinion which Petitioner quotes in its second question for the proposition that "the prospects of attaining monopoly power [by predatory pricing] seems slight" actually reads as follows: "Finally, if predatory pricing *conspiracies* are generally unlikely to occur, they are especially so where, *as here*, the prospects of attaining

monopoly power seems slight." 476 U.S. 574 at 590. (emphasis added). The quoted statement is not a ruling that "the prospects of attaining monopoly power [by predatory pricing] seems slight". It is simply an observation, based on the record in that case, of the implausibility of the conspiracy allegations in that case.

The Court did, in *Matsushita*, review the academic literature regarding predatory pricing and noted the skepticism of commentators regarding the likelihood of a firm achieving monopoly power through predatory pricing. However, the Court's observation of the literature does not constitute a ruling of the Court on a matter of law. While academics may continue to debate the extent to which predatory pricing occurs under various economic models, the issue must always be determined on the basis of the facts of a specific case. This Court did not hold otherwise in *Matsushita*.

Because Petitioner's second question is premised on a mischaracterization of the holding in *Matsushita* and is premised on factual assumptions which are contradicted by the record, it does not present a proper question for review on Certiorari. *Southern Power Co. v. North Carolina Public Service Co.*, 263 U.S. 508 (1924) (issues involving disputed issues of fact not proper for certiorari); *Accord, National Labor Relations Board v. Hendricks County Rural Electric Membership Corp.*, 454 U.S. 170, 176 n.8 (1981). The Court should deny the Writ of Certiorari as to the second question presented.

C. THERE IS NO CONFLICT IN THE CIRCUITS REGARDING THE ELEVENTH CIRCUIT'S HOLDING CONCERNING EVIDENCE OF PREDATORY INTENT.

The Eleventh Circuit's decision to consider subjective evidence of intent and to treat sales below average total cost and

above average variable cost as circumstantial evidence of predatory intent is consistent with the rulings of other circuits. No circuit has ever held, as did the District Court in this case, that subjective evidence of intent is irrelevant and should not be considered. *See, e.g., Instructional Systems Development Corp. v. Aetna Casualty & Surety Co.*, 817 F.2d 639 (10th Cir. 1987); *Henry v. Chloride, Inc.*, 809 F.2d 1334 (8th Cir. 1987); *Arthur S. Langenderfer, Inc. v. S.E. Johnson Co.*, 729 F.2d 1050 (6th Cir.), *cert. denied* 469 U.S. 1036 (1984); *William Inglis & Sons Baking Co.*, 668 F.2d 1014 (9th Cir. 1981), *cert. denied* 459 U.S. 825 (1982); *Northeastern Telephone Co. v. American Telephone and Telegraph Co.*, 651 F.2d 76, 91 n.24 (2d Cir. 1981), *cert. denied* 455 U.S. 943 (1982) (presumption can be rebutted). Nor has any circuit held that sales above average variable cost are conclusively non-predatory where there are barriers to entry and there is other evidence of predatory intent. *See, e.g. MCI Communications Corp. v. American Telephone & Telegraph Co.*, 708 F.2d 1081, 1113 n.40 and 1123 n.59 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983); *Sunshine Books, Ltd. v. Temple University*, 697 F.2d 90, 93 n.10 (3rd Cir. 1982) (declining to rule on the question).

Several circuits have treated sales above average variable cost as giving rise to a rebuttable presumption of non-predatory pricing. *See Instructional Systems Development Corp. v. Aetna Casualty and Surety Co.*, 817 F.2d 639 (10th Cir. 1987); *Henry v. Chloride, Inc.*, 809 F.2d 1334 (8th Cir. 1987); *D. E. Rogers Associates, Inc. v. Gardner-Denver Co.*, 718 F.2d 1431, 1437 (6th Cir. 1983), *cert. denied* 467 U.S. 1242 (1984); *Transamerica Computer Co. v. IBM Corp.*, 698 F.2d 1377 (9th Cir. 1983). *Cf. Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 233 (1st Cir. 1983) (approving Ninth Circuit rule). As the Eleventh Circuit pointed out, however, the difference between the test employed in these circuits and the Eleventh Circuit test is one of semantics rather than substance. (Pet. 25a n.37). Since the plaintiff has the burden of

proof, the effect is the same whether sales above average variable cost are "rebuttably presumed" to be non-predatory or, alternatively, they are "circumstantial evidence" of predatory intent which, without other evidence of intent, mean nothing. (Pet. 25a). Under either articulation, if the plaintiff fails to come forward with additional evidence of predatory intent, the defendant will be entitled to judgment as a matter of law. (Pet. 25a and n.37).

Even the Fifth Circuit, which has come closest to adopting a purely statistical approach to predatory pricing, has pronounced its unwillingness "in an attempted monopolization case, to relegate the intent element to the status of an automatic and irrebuttable inference." *Adjusters Replace-A-Car v. Agency Rent-A-Car, Inc.*, 735 F.2d 884, 890 (5th Cir. 1984), *cert. denied* 469 U.S. 1160 (1985). The Fifth Circuit also does not regard prices above average variable cost as presumptively non-predatory where there are barriers to entry, as in this case. *See International Air Industries, Inc. v. American Excelsior Co.*, 517 F.2d 714, 724 (5th Cir. 1975), *cert. denied* 424 U.S. 943 (1976) (average variable cost test not appropriate when there are barriers to entry). The Eleventh Circuit's ruling is, therefore, not in conflict with the decisions of other circuits.

D. THE ELEVENTH CIRCUIT'S HOLDING IS NOT IN CONFLICT WITH DECISIONS OF THE SUPREME COURT.

No Supreme Court case has ever held that proof of pricing below average variable cost is an essential element of an attempted monopolization claim or essential to proving predatory intent. Nor has the Court ever held that circumstantial evidence of Defendant's subjective intent is irrelevant to such a claim. In fact, although this Court has recently taken notice of the debate between the circuits regarding the weight to be given

cost-based analysis in predatory pricing cases, it has expressly declined to resolve the issue. *See Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 117, n.12 (1986). The only Supreme Court case which has expressly dealt with the issue of inferring predatory intent from below-cost pricing is *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967). In that case, brought under the Robinson-Patman Act, 15 U.S.C. § 13(a), the Court held that evidence of pricing below "direct cost plus an allocation for overhead", together with other evidence, was sufficient to support the jury's finding that the Defendant had violated the Robinson-Patman Act. 386 U.S. at 698-700. The Court in *Utah Pie* did not hold that a Plaintiff must establish sales below average variable cost in order to prove predatory pricing in violation of the Sherman Act. Nor did the Court hold that sales above average variable cost are *per se* legal. Rather, the clear holding of *Utah Pie* is that evidence that a Defendant's prices are below its "direct cost, plus an allocation for overhead" (i.e., average total cost), can give rise to inferences that pricing is predatory rather than competitive. The Eleventh Circuit's ruling is entirely consistent with *Utah Pie* and does not conflict with any other ruling of this Court.

E. THE ELEVENTH CIRCUIT'S RULING THAT RESPONDENT McGAHEE HAD INTRODUCED SUFFICIENT EVIDENCE FOR A JURY TO INFER A DANGEROUS PROBABILITY OF SUCCESS DOES NOT CONFLICT WITH THE HOLDINGS OF OTHER CIRCUITS.

Petitioner contends that the Eleventh Circuit's ruling is in conflict with decisions from other Circuits because it allows the jury to find a dangerous probability of success based solely on Petitioner's substantial market share at the outset of its predatory pricing scheme, without regard to the fact that Petitioner

actually lost market share to Respondent during the initial period after Respondent commenced operations. As noted above, Petitioner's argument is premised upon a mischaracterization of the Eleventh Circuit's ruling. While the Court did find Petitioner's 60 percent to 65 percent market share extremely significant, it also identified other evidence which would support a jury finding of dangerous probability of success, including: (i) evidence of barriers to entry into the market; and (ii) evidence of Petitioner's ability to charge supracompetitive prices after the competition was eliminated. 858 F.2d at 1495 n.11, 1505 n.44, 1506 n.45. (Pet. 9a n.11, 28a n.44, 30a n.45). The Court merely held that the Petitioner's large market share, on the facts of this case, was a "sufficiently large platform from which [Defendant's predatory pricing] scheme could be launched to create a genuine issue of material fact as to whether there was a dangerous probability that Northern Propane would succeed in achieving a monopoly." 858 F.2d at 1506 (Pet. 30a). *Accord, Multiflex, Inc. v. Samuel Moore & Co.*, 709 F.2d 980 (5th Cir. 1983).

The Eleventh Circuit's opinion does not conflict with the decisions of the Seventh Circuit which are cited in Petitioner's brief. Petitioner's cite to *Indiana Grocery, Inc. v. Super Value Stores, Inc.*, 864 F.2d 1409 (7th Cir. 1989), demonstrates the fact intensive nature of decisions on issues such as "dangerous probability of success"; the citation demonstrates the reasons why the facts of the cases must be carefully analyzed in order to determine whether there is any substantial conflict in the holdings of circuits such as to justify grant of the Writ of Certiorari. The facts in *Indiana Grocery* and the Seventh Circuit's holdings respecting these facts are sufficiently different from the record and the holdings in the instant case as to eliminate any concern for a conflict between the Seventh and Eleventh Circuits on the issue of dangerous probability. First, in *Indiana Grocery*, the market share of the alleged monopolist, Kroger, was 38 percent

of the relative market in 1983, and the market share had apparently further diminished to about 35 percent of the stipulated market by 1985, when the complaint was filed (though it was 50 percent in certain submarkets). This is significantly different from the 60 to 65 percent market share of the Petitioner in this case. Second, the Court found that on the basis of facts conceded by the Plaintiff Indiana Grocery, Kroger could not control a significant percentage of the productive assets in the market. This inability to control a significant percentage of the productive assets in the market was stated as the primary reason the Plaintiff could not develop sufficient evidence to successfully oppose Kroger's motion for summary judgment on the issue of dangerous probability. In the instant case, the record demonstrates that Petitioner's facility, i.e., its physical assets and distribution system, were located in the geographic heart of the market area (Pet. 2a); McGahee Deposition, Vol. I, p. 73 (R3-31); and the record establishes that transportation costs of propane are such that only entities with facilities in the market area can successfully compete. (Pet. 2a). Until Respondent McGahee opened for business, Petitioner thus controlled virtually all of the productive assets in the market area. After Respondent McGahee began his business, Petitioner continued to control the significant portion of the productive assets in the market area, and retained substantial excess capacity. Ingram Affidavit (R2-27). Thus, the record in this case demonstrates Petitioner Northern Propane has the control of productive assets which the Seventh Circuit specifically found Kroger did not process in *Indiana Grocery*.

Likewise, in *Indiana Grocery*, the Seventh Circuit specifically rejected the parties' stipulation that there were high barriers to entry in the market area, and the Court specifically found that barriers to entry were low. By contrast, in this case, the Eleventh Circuit has specifically found, and the record demon-

strates, that there are substantial factual questions regarding barriers to entry in the instant case. 858 F.2d at 1495 n.11 and 1505 n.44. (Pet. 9a n.11 and 28a n.44). *Indiana Grocery* is simply a very different case from the instant case. The factual differences, and the holdings of the Courts respecting these factual differences, are such that the Seventh Circuit's holding in *Indiana Grocery* on the issue of dangerous probability is not in conflict with the Eleventh Circuit's holding in this case.

The Eleventh Circuit's decision is also not inconsistent with *Ball Memorial Hospital, Inc. v. Mutual Hospital Insurance, Inc.*, 784 F.2d 1325 (7th Cir. 1986), which was also cited in Petitioner's brief. In *Ball Memorial Hospital* the trial court made findings of fact after an evidentiary hearing on a motion for preliminary injunction. The district court found, as fact, that the defendant lacked sufficient market power to restrict output in the market or to raise prices. *Id.* at 1331. The court also found, as fact, a highly elastic market and an absence of barriers to entry. *Id.* at 1331-1332. The Seventh Circuit held that these factual findings by the district court were supported by the evidence and were sufficient to support the district court's conclusion that the plaintiffs were unlikely to prevail on the merits and were therefore not entitled to a preliminary injunction. *Id.* at 1340. Nothing in the *Ball Memorial Hospital* opinion conflicts with the Eleventh Circuit's ruling in this case.

The Eleventh Circuit's ruling that a jury could reasonably find from Petitioner's 60 percent to 65 percent market share that there was a dangerous probability that Petitioner would succeed in its attempt to monopolize is consistent with prior rulings of this Court. In *American Tobacco Co. v. United States*, 328 U.S. 781, 797, (1946), this Court held that the existence of monopoly power may ordinarily be inferred from a predominant share of the market. *Accord, United States v. Grinnell Corp.*, 384 U.S. 563, 571, (1966) (87 percent market share "leaves no doubt

that . . . these Defendants have monopoly power"). Petitioner argues that the Eleventh Circuit's ruling on the "dangerous probability" issue conflicts with this Court's rulings in *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104 (1986) and *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986). However, neither *Cargill* nor *Matsushita* held that a 60 to 65 percent share of a stagnant, otherwise fragmented, market with barriers to entry could not be evidence sufficient to create a triable issue of fact as to whether there is a dangerous probability that the dominant firm will succeed in acquiring monopoly power.

F. THE PETITION DOES NOT FAIRLY PRESENT AN IMPORTANT FEDERAL QUESTION.

Respondent submits that the instant Petition for Writ of Certiorari does not fairly present an important federal question warranting the grant of Certiorari. As the Court below found, there are numerous issues of material fact in dispute, including whether or not Petitioner priced below its average variable cost, the existence of barriers to entry, and whether there was a dangerous probability that Petitioner would succeed in its attempt to monopolize. This Court long ago held that the Writ of Certiorari should not be granted on issues involving factual disputes. *Southern Power Co. v. North Carolina Public Service Co.*, 263 U.S. 508 (1924). As demonstrated above, the questions which Petitioner seeks to present to the Court are not actually presented by the opinion of the Eleventh Circuit below or by the record in this case. Because of the numerous factual issues in this dispute, the Court should deny the Writ and allow the case to proceed to a trial on the merits so that when and if the case appears again before the Court, the issues will be more properly focused and the record better developed.

IV. CONCLUSION.

For all the foregoing reasons Respondent respectfully requests that the Court deny the Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit.

Respectfully submitted,

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April 18, 1989

Appendix A

IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

H. FLOYD McGAHEE,	)	
	)	
Plaintiff,	)	CIVIL ACTION
VS.	)	FILE NO. C83-2617A
	)	
NORTHERN PROPANE	)	
GAS COMPANY,	)	
	)	
Defendant.	)	

AFFIDAVIT OF DR. BRUCE A. SEAMAN

Personally appeared before the undersigned officer authorized by law to administer oaths, Bruce A. Seaman, who having been duly sworn deposes and states as follows:

1.

I am Bruce A. Seaman, over the age of majority and suffering no disability to testify, and I make this my Affidavit of my own free will and volition, for all purposes in the above-stated civil action.

2.

I hold a Doctor of Philosophy in the field of Economics, obtained at the University of Chicago in 1978. Since 1978, I have been an Assistant and Associate Professor of Economics at Georgia State University and have in addition worked as a consultant with the Federal Trade Commission, in the area of anti-trust matters. Other details of my professional background are set forth in Exhibit C annexed hereto, consisting of three (3) pages and entitled "Curriculum Vita".

3.

Exhibit D annexed hereto consists of a list of materials which I have reviewed in order to assist me and provide factual assumptions upon which the opinions and statements made in the paragraphs which follow are in part based, and otherwise based upon my professional knowledge within the field of economics. Within the text which follows, materials considered by me in making this Affidavit are also indicated by parenthetical short-forms citation, with full citation supplied on Exhibit D annexed hereto.

4.

I have been asked by plaintiff's counsel to review and analyze, from the standpoint of current theories and techniques within economics, the Affidavit of Mr. Hugh S. Gower, (dated December 28, 1984), specifically regarding the following two issues: (1) Whether the economic analysis provided by Mr. Gower is accepted within economics as correct, most particularly whether a "price equal to average variable cost rule" is accepted as a sufficient test of preda-

tory conduct; and (2) Whether an analysis of the specific behavior of the defendant, Northern Propane Gas Co. in the Mitchell and Baker counties geographical market of the retail propane gas market from approximately March 1982 to approximately December 1983 could yield a finding, within accepted economics analysis, that Northern Propane had, in fact, engaged in predatory pricing and had in any way caused damage to competition in the relevant market.

5.

Based upon (i) a careful reading of Mr. Gower's affidavit, (ii) my knowledge of economic analysis, and (iii) the particular facts assumed by me at this time in the case from the specific sources set forth below, my conclusions as detailed in the following paragraphs are:

(a) The Areeda-Turner "average variable cost rule," relied upon by Mr. Gower, is in no way the consensus view within the economics profession. Mr. Gower's reading of the relevant literature is too narrow, and his exclusive reliance upon such a conservative standard for judging predation is too limited to adequately interpret such behavior at issue in this case.

(b) Because of the inherent limitations of the Areeda-Turner analysis of predatory behavior, Mr. Gower is led into several incomplete and misleading positions as to why Northern Propane's behavior should supposedly be viewed as a pro-competitive rather than predatory response to a new entrant. Specifically, he does not adequately demonstrate that Northern Propane's pricing was designed to increase short term profits as opposed to sacrificing such profits as part of a more dynamic, long term strategy to maintain its dominant position in the Mitchell/Baker market.

(c) A sufficient number of market characteristics and patterns of firm behavior, identified by economists as favorable to rational predatory pricing, are present in this particular case such that it is reasonable to infer (i) an intent on the part of Northern Propane to pursue a policy of predatory pricing, and (ii) a reasonable likelihood of success by Northern Propane.

6.

It is true that the Areeda-Turner analysis, and price relative to average variable cost more generally, have been given a prominent role in the economic analysis of firm behavior and of predatory conduct. However, it is now recognized by a wide variety of scholars that the Areeda-Turner rule generates a high probability that actual predatory conduct will be mislabeled as non-predatory. (See, for example, Joskow and Klevorick, "A Framework for Analyzing Predatory Pricing Policy," *The Yale Law Journal*, Vol 89, Dec. 1979, p. 238). This is due largely to its essentially static framework, which tends to understate the probability of rational predation strategy, as well as to its choice of a pricing threshold that would allow firms to meet too easily the assumed legal standard (of selling above average variable costs) while sacrificing short term profits. Numerous respected economists have published criticism of this inadequacy of the Areeda-Turner standard. (See for example, F.M. Scherer, "Predatory Pricing and the Sherman Act: A Comment," 89 *Harv. L. Rev.* 869 (1976); Oliver Williamson, "Predatory Pricing: A strategic and Welfare Analysis," 87, *Yale L.J.* 284 (1977); Joel Dirlam, "Marginal Cost Pricing Tests for Predation: Native Welfare Economics and Public Policy," *The Antitrust Bulletin*, Winter 1981;

William J. Baumol, "Quasi-Permanence of Price Reductions: A Policy for Prevention of Predatory Pricing," 89, *Yale L.J.* (1979); and A. Michael Spence, "Competition, Entry, and Antitrust Policy," in *Strategy, Predation, and Antitrust Analysis*, Federal Trade Commission, Sept. 1981). Even as conservative a legal scholar as Richard Posner has suggested a "long run marginal cost" rule in place of the Areeda-Turner short run marginal cost, or its imperfect proxy, "average variable cost" rule, pp. 184-196; "The Chicago School of Antitrust Analysis," 127, *U. of Pa L. R.* (1979), pp. 939-944.) Posner, in fact, has observed that "Any firm that sells at a price equal to its average variable costs . . . will be unprofitable. Therefore, even if the competitor is somewhat more efficient than the predator, a price equal to the predator's variable costs, and hence close to the competitor's variable costs, *should be an effective predatory price.*" (emphasis added: 127 *Univ. of Pa L.R.* (1979), p. 942). More fundamentally, Posner not only suggests an alternative pricing rule, but argues for a more thorough analysis of market conditions and strategic considerations when an alleged predator operates in more than one market. (See Paragraphs 15, 16, infra). He completely rejects the notion that a cost based test alone would be adequate to analyze predatory behavior: "There are two conventional approaches to the identification of predatory pricing, one through intent and the other through costs, and neither is adequate." (*Antitrust Law*, p. 188). Joskow and Klevorick have called for a "two tier test" combining an analysis of market conditions (entry barriers, market power considerations, profit analysis, and other factors) and a pricing test that would find a price below average *total* costs (as opposed to *variable*) predatory, unless the firm can show

that this strategy maximizes short run profits. (89 *Yale Law Journal, supra,* pp. 252-253). This approach has gained considerable recent acceptance, as recognized by the current leadership of the Federal Trade Commission. James C. Miller III and Paul Pautler note that "there are signs that the use of any simple benchmark is giving way to the use of cost-based tests in conjunction with analyses of intent, entry barriers, and structural factors that might be relevant in a full-blown rule of reason analysis." ("Predation: The Changing View in Economics and the Law," *The Journal of Law and Economics,* 28, (May, 1985), p. 497). They further note that recent decisions within the FTC apparently employ the two-tiered approach advanced by Joskow and Klevorick. (Ibid).

7.

Therefore, it is simply untrue that the Areeda-Turner test represents conventional economic wisdom. In fact, that test is widely viewed as outmoded, and prone to understate the likelihood of predatory conduct. In itself, the standard of "competitive price = average short run variable cost" is likely to allow a firm to successfully act in a predatory manner while meeting the standard, especially if there is excess capacity. In this regard, excess capacity generally yields a situation in which marginal costs are quite low (and far below long run marginal costs, as emphasized by Posner), and actually below average variable costs.

8.

Because the economic approaches presented in the articles referred to above are quite complex and some of them do not relate specifically to the case at hand, it is

useful to examine specific conclusions and theories presented by Mr. Gower's affidavit that are misleading without a more thorough analysis.

(Paragraphs 9 through 12 omitted.)

13.

Going beyond the Gower affidavit, it is possible to say more about the Northern Propane pricing scheme. A reasonable number of preconditions for rational predatory strategy exist in this case so that such intent on the part of Northern Propane and likelihood of success by Northern Propane can be reasonably inferred from the circumstances.

14.

It is widely acknowledged that an underlying premise of the Areeda-Turner price test is that predatory pricing by a dominant firm is unlikely to be a rational strategy for that firm. Several economists and legal scholars have used an essentially static analysis to correctly argue that the cost to the predator of such a strategy may be many times the cost to the competitive target. Thus, a predator must have an unusually deep reserve of financial resources (or for some reason an advantage in borrowing money in the financial markets relative to the target firm) to sustain such losses and earn the supposedly dubious right to try to raise prices later and recoup those losses while fighting off additional waves of potential entrants and fringe firms ready to expand sales into a now profitable market. (See McGee, "Predatory Price Cutting: The Standard Oil (N.J.) Case," 1 *Journal of Law and Economics* 137 (1958); L. Telser, "Cutthroat

Competition and the Long Purse, *J. Law and Econ.*, 9 (1966); and Robert Bork, *The Antitrust Paradox*, Ch. 7, pp. 144-159, Basic Books, 1978). Mr. Gower did not discuss or consider the circumstances under which a predatory pricing strategy could be rational. However, it is necessary to consider this subject in order to suggest that Northern Propane was engaging in potentially harmful predatory pricing.

15.

A threshold question that has been raised by Richard Posner (*Antitrust Law*, supra, pp. 184-185) is whether customers of a dominant firm would ever "cooperate" in a predatory pricing strategy by shortsightedly allowing a new entrant or fringe firms to expire in the face of price cuts by the aspiring monopolist. If pricing strategy of this type is ultimately designed to hurt customers in the long run, would not rational self interest induce customers to refuse to buy from the predator at such attractive short term prices? But Posner answers his own question by noting that if the number of buyers is large, or they are insufficiently informed and far-sighted to take these considerations into account, or if individual buyers decide to "free ride" by accepting the short term better price and hope that other buyers act "responsibly" to protect long term competition, such an argument for "super-buyer self protection" will not necessarily hold. In the Mitchell and Baker county market, there are a large number of buyers so that the free riding, short term argument assumes great plausibility. While McGahee had many loyal customers who would seem to want to act with this longer term perspective in mind (explained as an example of personal loyalty to him),

Plaintiff's Brief of Feb. 25, 1985 and Reply Memorandum of Plaintiff H. Floyd McGahee indicate that such loyal customers felt that they could not afford to bypass the unusually low prices offered by Northern Propane beyond some fairly small price differential. Thus, nothing in the facts presented indicates that a strategy of predatory pricing would fail because of lack of customer cooperation.

16.

Almost all commentators who have criticized the McGee, Telser, Bork, Areeda-Turner static approach to predation and consequent skepticism of the static approach about the frequency of predation, argue in some form that more dynamic, long term strategic considerations can lead to a rational strategy of predatory pricing. Such strategic considerations are especially prevalent in Williamson's work, *supra*, and in Scherer's writings, *supra*. Posner makes the point that "if, . . . a firm operates in a number of markets and faces actual or potential competitors each of whom is limited to one of its markets, it may find it worthwhile to expend considerable resources on crushing a single competitor in order to develop a reputation (for willingness to use predatory pricing) . . ." (*Antitrust Law*, supra, p. 185-186). This demonstration effect would supposedly reduce its overall costs of strategic entry deterrence even if it required the sustaining of large losses in any one market. In this context it is noteworthy that Northern Propane is a nationwide company with approximately 189 retail outlets nationwide as of 1982 (Plaintiff's Brief, Feb. 25, 1985, p. 1), while the plaintiff and the other competitors in the Mitchell and Baker market are local and operate in essentially one market area. (Ex. 79,

Document C00794, C00805). It is also noteworthy that Posner finds such strategic considerations so important that their presence reduces the need to depend on barriers to entry as a necessary condition for predatory pricing. (*U of Pa L.R.*, supra, p. 943). Thus, a strategy of predatory pricing may be rational, from Northern Propane's standpoint, because of the deterrent effect, even if the results were to impose large losses on Northern Propane in the relatively small Mitchell and Baker county market.

17.

The existence and quality of excess capacity is also an important consideration in evaluating the pricing practices of Northern Propane, or any competitor. Northern Propane argues strenuously, through the Gower affidavit, that they were operating with excess capacity and therefore were in the position that any sales that covered marginal cost (as measured by Mr. Gower as average variable cost) had to add to the firm's profitability and could not be predatory. Strictly speaking, Exhibit B, Diagram 4 suggests that merely being in a position where average total cost was not being minimized due to insufficient sales volume does not itself prove that a price that covers average variable cost is profit maximizing. The 75.2¢ price is still less than the profit maximizing price in that case. Furthermore, the excess capacity argument raises the issue of whether the cost test should be long run marginal cost rather than short run marginal cost. Posner has noted that price below long run marginal cost with intent to exclude should be an additional case of predatory pricing (price below short run marginal cost being the most basic case). (*Antitrust Law*, supra, p. 189). And a careful analysis of the IBM allegation

of predatory pricing in U.S. v. IBM (1969) notes that the appropriate marginal cost is short or long run depending on whether the firm has excess capacity. (F.M. Fisher et al. *Folded, Spindled, and Mutilated; Economic Analysis and U.S. v. IBM*, MIT Press, 1983, p. 274. Since long run marginal cost is a stricter cost test than average variable cost, the cost analysis performed by Mr. Gower is not complete because it fails to consider long run marginal costs.

18.

In light of the other factors in this case, the presence of any "excess capacity" as argued by Northern Propane, is not sufficient, in and of itself, to justify Northern Propane's price cuts in this case. This is explained in paragraphs 18 through 20. To understand fully the implications of excess capacity in relation to predatory market conduct, however, one must ask what caused such a condition. For example, the Joskow/Klevorick two-stage test (supra) includes the stipulation that pricing below short run average total cost can be considered non-predatory only if it can be shown to maximize profits. That, in turn, is likely only when substantial excess capacity exists *in the industry* (not just the dominant firm) for reasons other than strategic capacity expansion by a dominant firm (thus permitting evasion of even the most conservative marginal cost based tests). (supra, pp. 253-254).

19.

The two cases to consider in which "defensible" excess capacity could generate a profit maximizing price below average total cost would be (1) the dominant firm operates in a declining industry (for example, steel), and (2) the

entrant may have entered, at a scale sufficiently large that at a price equal to average total cost, industry capacity is underutilized as a result of new entry. (Joskow/Klevorick, supra, p. 253).

(Paragraph 20 omitted.)

21.

On the other hand, it appears that entry must occur at a fairly substantial market share in order to obtain enough sales to achieve a normal return on capital (assumed at 12%). The sale of 1,000,000 gallons a year, or 25% of the market estimated by McGahee (McGahee Affidavit), could serve as a legitimate entry barrier (scale not in absolute terms, but relative to the size of the market). However, it also suggests that once such a new firm entered, excess capacity in the industry could well exist. Four major factors mitigate against the possibility of excess capacity serving as an excuse for Northern Propane pricing below average total cost. First, to the extent that retail propane sales are highly sensitive to price, not just in response to an individual firm's price changes but to the general level of propane prices in the market, increased sales upon entry by McGahee would not have warranted such a large price reduction by Northern Propane (especially when compared to the surrounding territories; see below). Ex. 4, Document C00382 indicates that propane was highly sensitive to price. Under such circumstances it is unlikely that the immediate post entry price of the dominant firm (Northern Propane) would have imposed losses on itself, even though some price reduction would have been expected. Second, as cited above, the comparative pricing data provided at pages 52

and 56 of Plaintiff's Brief, filed Feb. 25, 1985, furnishes strong evidence that the price reductions were certainly not fully explained by any wholesale price cuts for propane (which in some instances rose rather than declined). Whether they could be explained by the possible excess capacity generated by McGahee's entry requires further analysis and data. However, the comparison to nearby, presumably competitive markets does provide a legitimate test, when properly controlled, of the difference between a long term competitive price and the short run, alleged predatory price. Such regional comparisons are commonplace and respected by economists (see Posner, *Antitrust Law*, supra, p. 66).

Third, commentary by officials of Northern Propane (cited in Plaintiff's Brief, supra) suggest clearly that McGahee was a feared and respected competitor, likely to be especially effective once he became established. Norgas officials note that McGahee had certain non-price competitive advantages that would apply once he was able to grow to a sufficient size to be more price competitive, so that then he could become an important market factor, in light of the seemingly ineffective other competitors currently in the market. This provides a pre-emptive motive for pricing very aggressively, beyond what a normal competitive response would suggest.

Fourth, the actual pricing practices become especially suspicious when the further assumption is made that the price cuts were rescinded after legal action was taken. While this might be viewed simply as a public relations move, it is just this kind of temporary pricing that led William J. Baumol (supra) to suggest a "quasi-permanence" test of predation. Under such a test, lower

prices must be maintained if the entrant leaves the market, or if the firms want to subsidize price cuts for other products. (p. 4). Similarly, Joskow and Klevorick observe that even the most seemingly innocent price cut, that of price remaining above average total cost should be subject to a "sustainability test." A price cut to a point above average total costs would be presumed legal unless reversed "fully or to a significant extent," within, say two years. (p. 255, supra). Thus, a reversal of the price cuts by Northern Propane could be viewed as supporting an inference of predation according to such tests, even if the price is not alleged to be as high as covering average total cost. Certainly, the dropping of price so as to yield a return on capital of 1.8% (Ex. 5, Document C00190) puts such pricing in a different category to that of IBM, viewed by Posner as a legal pro-competitive response to entry (IBM maintained return on sales of 20% - Posner, Antitrust Law, p. 196).

(Paragraph 22 omitted.)

23.

Finally, entry barriers into the Mitchell-Baker market, at least sufficient to significantly *delay* entry (an important point when the "returns" to a dominant firm's market power are calculated) seem to exist. In particular, the first, third, and fourth factors identified as entry barriers in H. Floyd McGahee's Reply Memorandum of April 10, page 5 (Wade Affidavit; Ingram Affidavit; Ex. 4, Document C00385; Ex. 5, Document C00190; Ex. 6, Document C00003; Holloway Affidavit; Taylor Affidavit; McGahee Affidavit), and briefly discussed above in the section on scale of entry

relative to market size, serve as economically valid and accepted considerations that can significantly delay or preclude entry. In addition, the many other firms in Georgia licensed to ship propane fuel must incur the costs of shipping, if they choose not to relocate and face the large scale entry problems of relocation. Given the costly distribution arrangements that must be made for the vast majority, about 96% of the sales, shipping in from a distance would be very non-competitive regarding price. This would provide some leverage for a dominant firm facing limited local competition to increase price.

24.

In summary, an analysis of the above assumed facts in this case to date permits the inference of predatory pricing and consumer damage, and certainly does not preclude such an inference. Furthermore, Mr. Gower's affidavit fails to substantiate the argument that a "price equal to average variable cost" test would be sufficient evidence of non-predatory conduct under the circumstances of this case.

/s/ Bruce A. Seaman
Bruce A. Seaman

Sworn to and subscribed before
me this 15th day of August, 1985.

/s/ Bonnie W. Johnson
Notary Public

Appendix B

IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

H. FLOYD McGAHEE,	)	
	)	
Plaintiff,	)	CIVIL ACTION
VS.	)	FILE NO. C83-2617A
	)	
NORTHERN PROPANE	)	
GAS COMPANY,	)	
	)	
Defendant.	)	

AFFIDAVIT OF H. FLOYD McGAHEE IN OPPOSITION TO DEFENDAN'S MOTION FOR SUMMARY JUDGMENT

1.

My name is H. Floyd McGahee. I am the Plaintiff in the above-captioned lawsuit. I am 56 years of age. I am not under any disability, and I am competent to make this Affidavit. I make this Affidavit on the basis of my own personal knowledge for use in opposition to a Motion for Summary Judgment which has been filed by the Defendant in this case, and for any other purpose authorized by law.

2.

On or about September, 1979, the Defendant Northern Propane Gas Company (hereinafter "Northern Propane") acquired a retail propane gas outlet located in Camilla, Georgia (hereinafter "Northern Propane Camilla Facility"). I became an employee of Northern Propane, at the time Northern Propane acquired the Northern Propane Camilla Facility. I had been employed at the retail outlet which was ultimately acquired by Northern Propane in September, 1979, for approximately 30 years. During this 30 year period, the retail propane outlet was owned by various companies, including Amoco Oil Company from whom Northern Propane purchased the retail outlet. I have been involved in the retail propane business in Mitchell and Baker County for 35 years. I am familiar with all aspects of the marketing of propane gas in the Mitchell County and Baker County market (hereinafter "Mitchell-Baker County market"). This includes all types of propane gas such as domestic gas used by households for heating and cooking, industrial and commercial gas used by industries in agricultural related companies, cylinder sales, and sales of what is called transport gas. I am familiar with the nature of the demand for all of these types of propane gas in the Mitchell-Baker County market. I am familiar with the wholesale cost of obtaining this gas, and I am familiar with the cost of operating a retail propane outlet. I am familiar with the identity and the nature of all of the various retail propane dealers who compete in the Mitchell-Baker County market, and I am familiar with the prices charged by these dealers.

3.

I am familiar with the type of machinery, equipment, and physical facilities necessary to maintain a retail propane outlet in the Mitchell-Baker County market. I am also familiar with the working capital requirements needed for the operation of such an outlet.

4.

Commencing in the late fall of 1981, and continuing through the spring of 1982, I began preparation for the opening of a retail propane outlet based in Camilla, Georgia, with the intention of serving the Mitchell-Baker County market. In obtaining the necessary machinery, equipment, storage tanks, customer tanks, office, delivery trucks and other physical assets, I sought to keep my cost to a minimum. Nevertheless, my total cost for the physical assets necessary for me to enter the retail propane business in the Mitchell-Baker County market totalled $827,000.00. In my opinion, it is not possible for any person to enter the Mitchell-Baker County market without expending at least the money I spent, that is $827,000.00, for the physical assets necessary to go into business. In addition, a person entering this market must be prepared to generate or obtain working capital in the range of $150,000.00 to $300,000.00, as the business expands. The need for this working capital is related to the operation of the business. It depends in part on the generation of accounts receivable by the retail propane outlet. It also depends on other factors such as the necessity for providing customer's tanks at the customer's locations. At the end of seven (7) months operation in December, 1982, my outstanding accounts receivable were $155,342.00.

At the end of nineteen (19) months operation in December, 1983, my outstanding accounts receivable were $274,470.00.

5.

In the Mitchell-Baker County market, most of the purchasers of propane do not own their own tanks. The large users expect to have tanks provided without cost to the user, and at the expense of the propane dealer. The smaller domestic users expect to be able to rent their tanks for fairly nominal amounts.

6.

The size of the retail propane market in the Mitchell-Baker County market area is approximately 4,000,000 gallons. By this I mean that in a normal year, my experience and information indicates that the various competitors selling retail propane in the Mitchell-Baker County market would sell a total of approximately 4,000,000 gallons.

7.

In my experience, any person or entity investing in a retail propane business, like any person investing in any other business, expects to obtain a reasonable return on the capital investment made for the purpose of going into the business. In my experience, the minimum return on invested capital which is considered reasonable in the propane business is at least 12% per annum. Many retail outlets generate much higher returns on capital investment. When I was employed by Northern Propane, each branch or district manager including myself, was given as a goal for each of the branch operations, the generation of a

return on investment of at least 18% per annum. Based on my experience, no person or entity would enter a retail propane market for the purpose of competing with existing retail outlets serving that market area, unless that person or entity could expect to receive at least a 12% per annum return on capital investment.

8.

For the reasons set out above, a person entering the retail propane business in the Mitchell-Baker County market must be prepared to expend a total of approximately $975,000.00 to $1,125,000.00 for both fixed assets and working capital. In order to receive a return of 12% per annum on this invested capital, a person would therefore expect to receive a return of approximately $120,000.00 to $135,000.00. If a new entrant to the Mitchell-Baker County market assumes he will reach sales of 1,000,000 gallons per year, the new entrant would need to recover in the range of 12¢ per gallon to 13.5¢ per gallon above all direct and indirect costs in order to receive a 12% return on investment. Based on my experience, I believe it would be extremely difficult for a new entry in the Mitchell-Baker County market to make the 25% market penetration necessary to sell 1,000,000 gallons of retail propane per year. And if a new entrant in the market is able to make a 25% market penetration and obtain sales of 1,000,000 gallons, the question of whether the new entrant is able to receive a 12¢ to 13.5¢ per gallon return above all direct and indirect costs will depend almost entirely on the price for which the propane can be sold, in relation to the wholesale cost of propane. For the foregoing reasons, I believe there are substantial economic

barriers to persons or entities entering the retail propane market in Mitchell and Baker Counties, Georgia.

9.

In addition, there are other intangible and noneconomic barriers to entry including long standing relationships between customers and various entities presently in the market.

10.

At the time I was preparing to enter the retail propane market in the very late fall of 1981 and the early part of 1982, the retail prices for propane in the Mitchell-Baker County market, were generally in the range of 78¢ to 80¢ per gallon for industrial propane and 88¢ to 90¢ per gallon for domestic propane. Green Propane, Farmer's Gas, and Modern Gas were all competing in the market area during this time; the prices of each of these entities was generally in this range. At the beginning of 1982, the prices charged by Northern Propane were approximately 75¢ for industrial gas and 80¢ for domestic gas. I had anticipated opening for business, using these prices: *i.e.*, 75¢ per gallon for industrial gas and 80¢ for domestic gas.

(Paragraphs 11 through 28 omitted.)

29.

None of the other competitors in the Mitchell-Baker County market sold domestic propane as low as the prices at which Northern Propane sold domestic propane in 1983.

30.

Because of Northern Propane's drastic price cuts in domestic gas, I was forced to sell domestic gas at prices lower than I otherwise would have been able to sell domestic gas. In addition, I lost business because I was not able to sell propane gas at prices as low as the prices at which Northern Propane was selling.

31.

If I had known in advance that Northern Propane was going to cut the prices of domestic and industrial propane as it did in the Mitchell-Baker County market in 1982, I would never have gone into the retail propane business in that market. Based on my experience it would not be reasonable to enter a retail propane market in which a competitor was pricing retail propane as Northern Propane priced that product during 1982 and 1983. This is so because if a person attempts to meet these low prices charged by Northern Propane, the person will not receive a reasonable return on the investment of approximately $1,000,000.00 required to enter the market; indeed a person charging the prices charged by Northern Propane, will operate at a loss.

32.

Northern Propane inflicted losses on me in the conduct of my business in several ways in 1982 and 1983. First, Northern Propane's reduced prices caused me to sell propane gas at prices lower than the prices which I would have otherwise sold propane gas, thus causing losses: second, Northern Propane's low prices caused me to lose business and fail to obtain business because I simply could not meet the low prices charged by Northern Propane; fi-

nally, the low prices charged by Northern Propane in conjunction with the cash discount policies and the free tank rental policy increased my working capital needs.

33.

After I filed this suit, Northern Propane's prices began to increase during 1984 and 1985. If Northern Propane had continued pricing its propane gas during 1984, and during 1985, as it did in 1982 and 1983, I may not have been able to withstand the serious losses I would have continued to suffer.

34.

Based on my 35 years experience, prices such as those charged by Northern Propane in 1982 and 1983 in the Mitchell-Baker County market are such as will exclude other competitors from the market.

FURTHER AFFIANT SAYETH NOT.

/s/ H. Floyd McGahee
H. FLOYD McGAHEE

Sworn to and subscribed before
me this 25th day of February, 1985.

/s/ Jeanne Ketchum
Notary Public